



THE CITY OF SAN DIEGO **MANAGER'S REPORT**

DATE ISSUED: November 24, 2004

REPORT NO. 04-258

ATTENTION: Honorable Mayor and City Council
Docket of November 29, 2004

SUBJECT: Fiscal Year 2004 Independent Auditor

SUMMARY

Issue – Should the City of San Diego enter into a sole source agreement with Macias, Gini & Company, LLP to perform the independent audit of the City's Fiscal Year 2004 financial statements?

Manager's Recommendation – Authorize the City Manager to enter into a sole source agreement with Macias, Gini & Company, LLP to perform the independent audit of the City's Fiscal Year 2004 financial statements.

Other Recommendations – None.

Fiscal Impact – The cost for auditing the City of San Diego's Fiscal Year 2004 financial statements is estimated not to exceed \$715,479. The General Fund's portion is \$360,775 and the non-general funds' portion is \$354,704. The General Fund has \$403,493 included in prior year encumbrances for this purpose. The balance of the costs will be shared throughout benefiting funds (non-general funds) using either fund balances or expenditure savings.

BACKGROUND

The City of San Diego retains an independent certified public accountant (CPA) to audit the City's financial statements in compliance with Generally Accepted Accounting Principles (GAAP). Ideally, the independent auditor is retained no later than May with the financial statements and audit being complete by December of that year. The City is not able to maintain that schedule for Fiscal Year 2003 and Fiscal Year 2004 financial statements due to several circumstances including the errors found in our Fiscal Year

2002 financial statement footnotes and the ongoing investigations regarding the City's financial disclosure practices.

In order to set better guidelines for publicly traded companies, the federal government approved the Sarbanes Oxley (SOX) Act of 2002. In very simple terms, SOX requires a significant increase in reporting requirements as well as strengthen internal controls for publicly traded companies. The enactment of SOX appears to have more than doubled the work of CPA firms which provide services to publicly traded companies. As a result of SOX, the workload for the big four accounting firms, as well as many others, has increased significantly. This then diminishes the accounting resources available to provide services to the lower fee paying non profits and governmental agencies.

For Fiscal Year 2003, KPMG is auditing the City's financial statements and the City does not yet have an estimated date of completion. The City discussed the potential of KPMG auditing the Fiscal Year 2004 financial statements once they are completed with the Fiscal Year 2003 financial statements. KPMG replied that they expect to have resources available in April that they could make available to initiate this work. If KPMG could begin in April it could take approximately six months to complete the Fiscal Year 2004 audit delivering the audited financial statements in the fall of 2005. This timeframe is much later than the City would prefer.

In order to facilitate a review of the Fiscal Year 2004 financial statements, the City then contacted other CPA firms to explore their interest and availability to work with the City. What the City found is that the large accounting firms have very little resources available to take on additional government work. One of the firms the City approached was Macias, Gini & Company, LLP. The City Manager's Office met with representatives of their firm and determined that they were a well qualified firm and they were interested in making resources available to conduct an audit of the City of San Diego's financial statements in a timely manner.

DISCUSSION

Given the importance of the timely and accurate review of the Fiscal Year 2004 financial statements, the City Manager is recommending a sole source contract with Macias, Gini & Company, LLP (Macias Gini). Macias Gini was established in 1987 and is a full-service accounting and consulting firm which specializes in government accounting. The engagement team proposed by Macias Gini appears to have the professional and industry experience to provide quality accounting/auditing services to the City of San Diego. Other large California government entities that have been audited by Macias Gini include: City of Los Angeles, City of San Jose, City of Oakland, City/County of San Francisco, County of San Diego, Santa Clara County, Sacramento County and San Mateo County. Each of these municipalities has reported positive experiences with the firm.

The sole source contract is allowed under Municipal Code Section 22.3212(d). Given the already late timing in initiating the review of the Fiscal Year 2004 audited financial statements, a sole source is the preferred solution since a procurement process could add 6 – 8 weeks to an already delayed timeframe. In addition, KPMG, the City's current auditor, is not expected to have staff resources available until April, 2005 to begin the

audit of the Fiscal Year 2004 financial statements. If it is assumed that it takes approximately six months of review, their completion of the audit would not occur until fall 2005, clearly much later than preferred. With Macias Gini, we expect that they will begin their audit in December 2004 and have it complete by late spring. This will provide the opportunity for the City to enter the financial markets for conventional debt financing for capital improvement projects and refunding of existing bonds. The City has obtained interim funding for the Metropolitan Wastewater Department capital improvement projects.

Retaining Macias Gini will allow the City to continue to work with KPMG on the Fiscal Year 2003 financial statements while working with Macias Gini on the Fiscal Year 2004 financial statements. It is important to note that Macias Gini will be unable to complete their review of the Fiscal Year 2004 financials without the completion of the Fiscal Year 2003 financials. However it is vital for the two firms to work concurrently on both fiscal years to enable the City to return to a regular schedule for producing annual financial reports.

For Fiscal Year 2005, it is recommended that the City of San Diego and its related agencies conduct a procurement process for multi-year audit services and work directly with the Financial Reporting Oversight Board which will be established shortly. The newly created Financial Reporting Oversight Board would be involved in the procurement process and selection of the Fiscal Year 2005 independent auditor and beyond consistent with the City ordinance adopted by the City Council on October 11, 2004.

The scope of work for the Fiscal Year 2004 financial statement audit is attached (Attachment A). Many of the City's agencies have progressed along with their Fiscal Year 2004 audits by Caporicci and Larson, LLP, and they have agreed to partner with the City of San Diego for the selection of the Fiscal Year 2005 independent auditor.

ALTERNATIVE

Do not authorize the sole source agreement with Macias, Gini & Company, LLP and initiate a procurement process. However we would recommend against this alternative to avoid having additional delays negatively impacting the City's ability to return to the conventional bond markets.

Respectfully submitted,

Lisa Irvine
Financial Management Director

Approved: P. Lamont Ewell
City Manager

Attachment A: Scope of Services